No. 11,703

IN THE

United States Circuit Court of Appeals

For the Ninth Circuit

GEORGE B. CAREY,

Appellant,

vs.

HILO FINANCE & THRIFT CO., LTD., a Corporation,

Appellee.

Upon Appeal from the Supreme Court of the Territory of Hawaii.

APPELLANT'S REPLY BRIEF.

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PERNAU-WALSH PRINTING CO., SAN FRANCISCO.

Subject Index

Page

Consideration of seven of the notes sued on, the proceeds of which were applied to defendant's antecedent note indebtedness failed in part or totally because defendant's antecedent note indebtedness was tainted with and consisted wholly or in part of unrecoverable usury and compound interest, defendant having paid such part of his antecedent indebtedness as constituted a valid obligation 1

Conclusion 18

Table of Authorities Cited

Cases

Pages

Commonwealth v. Loan Corporation, 116 Pa. Super. Ct. 365, 176 Atl. 516 4

Frazier v. Investment Company, 47 Ga. App. 585, 157 S. E. 102 5

Lanier v. Consolidated Loan Company, 47 Ga. App. 148, 170 S. E. 99 5

Nawahi v. Trust Company, 30 Hawaii 359 18

Statutes

Session Laws of Hawaii, 1939, Section 6782 N 5, 7

Revised Laws of Hawaii:

Section 7604 (1935) 5

Section 8737 (1945) 5

Texts

55 Am. Jur., Usury, Section 54 10

66 C. J., Usury, Section 203 10

10 C. J. S., Bills and Notes, Section 153 10

11 C. J. S., Bills and Notes, Section 155, page 80 10

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CONSIDERATION OF SEVEN OF THE NOTES SUED ON, THE PROCEEDS OF WHICH WERE APPLIED TO DEFENDANT'S ANTECEDENT NOTE INDEBTEDNESS FAILED IN PART OR TOTALLY BECAUSE DEFENDANT'S ANTECEDENT NOTE INDEBTEDNESS WAS TAINTED WITH AND CONSISTED WHOLLY OR IN PART OF UNRECOVERABLE USURY AND COMPOUND INTEREST, DEFENDANT HAVING PAID SUCH PART OF HIS ANTECEDENT INDEBTEDNESS AS CONSTITUTED A VALID OBLIGATION.

It was not contemplated that installments of defendant's 46 notes would be paid in cash when due—they never were—but that new notes of defendant would replace them. Defendant made a new note each

month for four years, part, if not all, of the consideration of which was the discharge of installments due on older notes with four exceptions (R. 31, 221, 230, 236). When the first installment of $155.32 of a note for $2330 became due, plaintiff credited defendant with payment thereof and took defendant's second note covering the $155.32, credited on the first note, plus $1844.68 advanced to defendant (Appellant's Brief, page 8) and interest of $330 on the total of $2000. Thus plaintiff charged interest monthly on the amount necessary to cover installments due on prior notes which were themselves packed with interest. Such was the bargain. Herein is the clue to plaintiff's excess charges. The point was not adverted to by the Supreme Court. It was not brought to the Court's attention.

Plaintiff's witness, Hugh Tennent, testified that he made all arrangements between the parties (R. 59), and that the first agreement was for defendant to borrow $12,000 or $15,000 in 12 monthly borowings (R. 72). Pursuant to this agreement, defendant actually borrowed $13,885.04 in 13 borrowings, that is to say, defendant received a total of this sum in diminishing cash advances over a period of 13 months (Appellant's Brief, pages 6-8). It was, therefore, a part of the first agreement between the parties that the defendant should receive diminishing sums monthly on notes for $2330 and that the difference between these sums and $2000, the purported actual loan was to be applied to installments on prior notes due at the time the cash advances were made.

Plaintiff's witness, Hugh Tennant, further elaborated on the practice of applying portions of the proceeds of monthly notes to installments due on prior notes (R. 77, 78, 81, 83). This witness further testified that, except when the defendant received the entire proceeds of notes in cash (this happened only four times (R. 31, 221, 230, 236) in the four years involved) the proceeds were applied in part to installments due on former notes (R. 78). As pointed out below, $67,764.60 or 436 installments of $155.32 each were taken care of by notes.

Appellant's Exhibits 1-A to 38-A (R. 191-238) and Appellee's Exhibits A-1 to H-1 (R. 22-43), show that installments on all notes were paid consistently each month as new notes were given, and that the proceeds of practically all the notes were credited in part to pre-existing notes.

The figures in this case are nothing short of fantastic in comparison with amount of actual money involved. It appears from Appendix I, Appellant's Brief, which may be verified by comparison with the record that the defendant executed notes payable to the plaintiff in the total sum of $104,850 ($117,665, total of third column less total of first five notes, aggregating $5825 which antedated notes involved and less three notes aggregating $6990 coming after last note sued on), of which $67,764.60 was paid by credit derived from notes ($78,813, total of seventh column less total of first five notes, $5825 minus credits thereon of $776.60 or $5048.40 and less the $6000 of credits from notes coming after the last sued on dated Febru-

ary 28, 1938). It is clear, therefore, that the understanding of the parties was that monthly installments on defendant's notes were to be paid, as they were in fact paid by interest bearing notes for the interest bearing installments.

Defendant had no alternative but to execute new notes with which to pay old ones. He could not pay in cash (R. 139). Plaintiff, being amply secured (R. 118, 119) was indulgent by accepting defendant's notes for compound interest. The continuity of the transaction and the compounding of interest at 30-day intervals are earmarks of the vice involved. The practice was oppressive against public policy and reprehensible. Plaintiff may not recover on the notes to the extent of the compound interest covered by them.

In *Commonwealth v. Loan Corporation,* 116 Pa. Super. Ct. 365, 176 Atl. 516, a money lender loaned $150 to a borrower on a note payable one day after date with interest at 3½ per cent per month in 20 equal installments of $7.50 each. On December 17, 1928, money lender made a further loan for $30 with interest at 3½ per cent per month, taking borrower's note. On April 10, the money lender took another note from the borrower in the sum of $200 with interest at 3½ per cent per month. The principal of the note represented $134.36 due on the $150 note and interest thereon of $35.27 and $22.60 balance of principal on the $30 note and interest thereon of $2.07, cash balance to borrower of $.18. When the $200 note was given on April 10, 1930, the $150 loan and the $30 were marked paid. The Court said:

> This (allowance of compound interest) is not so, where as here a large rate of interest is originally charged as provided for in the statute and there is a specific provision that no additional charges, etc., shall be made. That is an expressed warning to money lenders that interest cannot be compounded. It would be against public policy thus to impose additional interest upon those who must by force of necessity pay higher rates to provide for their immediate needs.

The defendant, money lender, was convicted under penal provisions of the loan statutes involved.

The loan statutes involved in the instant case, namely, Section 7604, Revised Laws of Hawaii, 1935, and Section 6782-N, Session Laws of Hawaii, 1937, contain no express prohibition against the compounding of interest. Section 6782-N provides, however, that no licensee money lender shall directly or indirectly charge, contract for or collect or receive any interest, discount, fees, charges, or other consideration on any loan or loans made by it, except as provided by the section. This provision taken together with the statutory interdiction of compound interest *eo nomine* contained in Section 8737, Revised Laws of Hawaii, 1945, which was in force during the period covered by the notes clearly deprives the plaintiff of any claim for compound interest.

See also *Frazier v. Investment Company,* 42 Ga. Ap. 585, 157 S. E. 102; *Lanier v. Consolidated Loan Company,* 47 Ga. Ap. 148, 170 S. E. 99.

The interest charged by plaintiff in the sum of $330 for a $2000 loan was for the use of $2000 for 15 months. Plaintiff was entitled, however, to require monthly installments of the total of the principal and interest, thus exacting interest on increasing portions of the principal of which defendant did not have the use after the first month. But it is certain that plaintiff was not entitled to more interest than one per cent per month for 15 months on the total loan. The sum of $155.32, representing the first monthly installment, was part of the $2330 for the use of which for 15 months plaintiff had charged interest in the sum of $330. Plaintiff, therefore, would not be entitled to charge additional interest for the use of this same $155.32 for the balance of the same 15 months' period. Otherwise, the right to require payment of principal and interest in installments would authorize collection of unearned interest on increasing parts of the principal which the installments paid and double interest on the installments, i.e., prepaid interest on the principal for 15 months and interest on installments of the principal for the same period. Nor may plaintiff indirectly charge interest on installments by charging interest on fictitious advances or credits with which to pay the installments.

If plaintiff's authority to require monthly installments justified the agreement between the parties, whereby defendant gave and plaintiff accepted monthly interest bearing notes instead of cash in payment of the installments, plaintiff's authority to declare the whole indebtedness due upon defendant's

default in any installment would justify an agreement between the parties, whereby defendant would default in paying the first installment and plaintiff would thereupon declare principal and 15 months of interest thereon due, collecting $330 for the use of $2000 for 30 days.

Section 6782N, Session Laws of Hawaii, 1939, confers only one right on the lender in case of the borrower's default in an installment, namely, to declare the whole debt due. The right to exact interest within the term of the loan on an installment which carries its own interest for the term or on credit or cash with which to meet the installment is not provided and is excluded by the *expressio unius est exclusio alterius* rule of construction as well as by statute's limitation on interest. If plaintiff may not by antecedent agreement with defendant charge him interest on the interest bearing installments during the term for which the interest on the installments was computed, plaintiff may not charge interest on a sum equal to the installment and take defendant's note in the sum plus interest in lieu of the installment.

Suppose plaintiff had proposed to defendant as follows: "I cannot charge you more than $330 for a loan of $2000 for 15 months. But I am entitled to require equal monthly payments of $155.32, and, if you will be good enough not to pay the installments when due and give me instead a note for $155.32 bearing interest at the maximum rate of one per cent per month for the remainder of the 15 months' period, I can charge you interest for 15 months on the first

note, interest for 14 on the second and so on for a total of 120 months or a total interest of 120 per cent making $186.36 in addition to the original charge of $330." This, indeed, is what plaintiff did.

Or suppose plaintiff had proposed to defendant as follows: "I cannot charge you but $330 for a loan of $2000 for 15 months. But I am entitled to require equal monthly installments of $155.32 each and to declare the entire balance due if you fail to pay any installment. If you will be good enough not to pay the first installment when due, I shall declare the total sum of $2330 due. In this way, I can charge you $330 interest for the use of $2000 for one month."

Both of the above hypothetical cases are regular on their face and pursuant to agreement of the parties. But in both cases, excessive interest is charged.

It is assumed *arguendo* that an initial note for $2330 payable in 15 monthly installments of $155.32 in consideration of a $2000 advance is valid and enforceable. Each installment carries its 1/15 part of the $330 interest or $22 and its 1/15 part of the $2000 principal or $133.33, making the total of $155.32. Now for the second note for $2330, defendant gets $1844.68 and a credit of $155.32 to cover the first installment in this amount of the first note which included interest. His second note embraces $330 in interest for both the cash and the credit of $155.32, that is to say, $25.63 of the interest of $330 carried by the second note is interest for the credit of $155.32 on the first installment of the first note which included $22 of interest. $3.63 of the interest of $25.63 is interest on

the $22 interest in the first installment of the first note. The first and each installment of the second note embraces its proportionate or 1/15 part of this interest of $25.63 or $1.70, and its proportionate or 1/15 part of the credit of $155.32 or $10.35, making a total of $12.06, that is to say, each installment of the second note in the sum of $155.32 embraces $12.06 as accounted for.

The third note pays the second installment of the first note of $155.32 which included $22 of interest and paid also $25.63 for the credit of $155.32, the $25.63 including $3.63 interest on the $22 interest. The third note also paid the first installment of the second note in the sum of $155.32 which embraced $1.70 interest and in addition, paid $25.63 interest on the amount of $155.32 paid on the second note. The third note thus paid $310.64 which included interest on the first and second notes and $51.26 interest thereon or $361.90 and produced cash of $1,689.36. Each installment of $155.32 of the third note included its 1/15 of the $51.26 interest or $3.41, the balance of $151.91 covering 1/15 of the cash advance of $1,689.36 and interest thereon.

The fourth note paid the first installment of $155.32 of the third note, including $3.41 interest and the second installment the second note and the third installment of the first note paying three installments totalling $465.96 and a total interest thereon of three times $25.63 or $82.89, each installment of the fourth note carrying 1/15 of this interest or $5.53.

For the purposes of illustrations, the twelfth note paid eleven installments on prior notes and eleven times interest of $25.63 on each or $281.93. Each installment of $155.32 of the twelfth note carried 1/15 of this interest or $18.72. The thirteenth note paid, among other things, the first installment of the twelfth note and $25.63 interest thereon, $3.09 of the interest being interest on the $18.72 interest in the installment of the twelfth note paid.

Enough has been said to show and illustrate the compounding of interest at 30-day intervals which continued over a four-year period. The total compound interest charged is reflected in the notes to which the proceeds of seven of the notes sued on were applied (R. 22-25-28-34-37-40-43). Compound interest is not recoverable under Revised Laws of Hawaii, 1945, Section 8737 in force throughout the period covered by the notes. There is therefore, either a total or partial failure of consideration for these notes. If partial, the notes are void to this extent, 10 C. J. S. Bills and Notes, Section 153. The burden in such a situation is on the plaintiff to show the consideration, 11 C. J. S. Bills and Notes, Section 155, page 80. Remand for reference to an auditor is strongly indicated.

Under the above cited statute prohibiting compound interest, the notes involved are *ipso facto* tainted with usury. 55 Am. Jur. (Usury) Section 54. The notes sued on given to pay former notes tainted with usury are themselves tainted with usury. 66 C.J. Usury, Section 203.

Calculation of compound interest on each of the almost 500 installments would be interminable. Defendant will, therefore, content himself with a calculation of compound interest on the notes as a whole without regard to the compound interest on the intersticed installments included in the notes. The Court will find it convenient to refer to Appendix I, Ap. Brief which may be verified as a composite (or compound denoting the interest charges) of R. 232 showing cash paid by plaintiff and R. 189-238 and R. 20-43 showing notes, application of proceeds thereof and payments thereon.

After the execution of the fifth note before the first note involved dated April 10, 1934, four installments of $77.66 each of the first note were paid by credits from the fifth and the three preceding notes, leaving eleven installments thereof unpaid; three installments of the second note were likewise paid with 12 unpaid; two installments of the third note were likewise paid with thirteen unpaid, one of the fourth installment was likewise paid with fourteen unpaid, fifteen of the fifth installment were unpaid, i.e., $776.60 was paid and $5,047.90 was unpaid of the five notes before the first note involved herein of April 10, 1934.

The last mentioned note paid $388.30 or five installments of $77.66 each of the first five notes reducing the balance thereon of $5,047.90 to $4,659.60. (Compare Appendix I, Ap. Brief, with R. 191 for item of $388.30. The latter has $310.64 to Realty Investment Company and $77.66 to plaintiff, a total of $388.30.

The same difference appears in accounting for proceeds of next ten notes but is immaterial for present purposes). The following ten notes each paid $388.30 on the first five notes and all together they paid 55 credits of $155.32 each or $8,542.60. First note paid one credit, second note two credits and so on (R. 194-207) on installments due on the first ten notes beginning with the April 10, 1934 note, leaving 95 installments totalling $14,755 unpaid thereon, and the whole eleventh note for $2330 due, totalling $17,085 due on the eleven notes beginning with the first note involved dated April 10, 1934. $3883.00 (ten payments of $388.30 each) paid on the first five notes reduced the balance thereon from $4,659.60 to $776.60. Hence, $17,861.60 was due on all notes after execution of the note of February 19, 1935, and before the cash payment of March 21, 1935.

For these eleven notes beginning with the April 10, 1934 note and totalling $25,630 of which $3630 was interest, defendant received $4271.30 in credit on the five notes antedating the notes sued on, to which no exception will be taken in the present analysis. He received also $9186 in cash to which no exception will be taken. In addition, he received credit of $8,542.60 on notes of this series. Defendant paid $3630 in interest for the total principal of $22,000 (11 notes). For the credit of $8,542.60 on notes of this series, i.e., eleven notes beginning with the April 10, 1934 note, he paid $1,409.65 in interest incurring a note indebtedness of the total of $9,952.25 for the credit of

$8,542.60. This interest of $1,409.65 is hereby designated as an unrecoverable portion of defendant's note indebtedness to which reference will be made in the recapitulation.

After February 19, 1935, and before the next note of June 12, 1935, defendant paid plaintiff $5,824.80 in cash (R. 232) reducing the note indebtedness from $17,861.60 to $12,036.80, the balance due of $776.30 on the oldest notes antedating the notes involved being wiped out. Hence, a note indebtedness of $12,036.80 on notes beginning with the April 10, 1934 note was due when the note of June 12, 1935 was executed. The next six notes beginning with the June 12, 1935 note (for $13,980) paid $11,106.48 of this $12,036.80 note indebtedness, leaving $930.32 due. On these six notes, defendant received $893.52 in cash. He paid $1980 interest for both the cash and the credit or $147.43 for the cash and $1,832.57 for the credit. Of the $13,980 total of these six notes, $11,106.48 went to prior notes and $1,832.57 to interest on this $11,106.48, total $12,939.05 to cover balance on eleven notes beginning with the April 10, 1934 note. This interest of $1,832.57 will be referred to in the recapitulation as unrecoverable usury.

When defendant executed the note of January 28, 1936, he owed the above balance of $930.32 on notes due when the June 12, 1935 note was executed, plus a note indebtedness of $12,939.05 including $1,832.57 interest to pay $11,106.48 on notes before June 12, 1935, this indebtedness arising out of the six notes

beginning with June 12, 1935. On January 28, 1936, defendant thus owed a note indebtedness of $930.32 representing balance due on notes when June 12, 1935 note was executed and $11,106.48 applied to indebtedness on eleven notes beginning with the April 10, 1934 note, plus interest of $1,832.57 on the latter sum—total $13,869.37. He also owed a note indebtedness to cover the $893.52 cash received by him on the six notes beginning with the June 12, 1935 note and interest thereon of $147.43 or $1,040.95, making a grand total of $14,910.32.

Taking the next nine notes beginning with the January 28, 1936 note for convenience because they almost paid off the above grand total of $14,910.32, these nine notes paid $14,116.16 of the grand total, leaving a balance of $794.26. On these nine notes, defendant received $3,884.04 in cash. Defendant paid $2970 interest for both the cash and credit or $642.86 for the cash and $2,329.17 for the credit. Of the total of $20,970 of these nine notes, $14,116.16 went to prior notes and $2,329.17 to interest on this $14,116.16, making a total indebtedness of $16,445.33 arising out of these nine notes to pay the indebtedness of $12,-939.05, including interest of $1,832.57 arising out of the preceding six notes which was incurred to pay $11,106.48 of the indebtedness on notes beginning with the first note involved of April 10, 1934. (The above indebtedness of $16,445.36 also went to pay a balance of $936.02 antedating the June 12, 1935 note.) The

above interest of $2,329.17 will be referred to in the recapitulation as unrecoverable usury.

After this series of nine notes, defendant owed a preexisting balance of $794.26, which their proceeds, except cash, were insufficient to cover, and the total face of the nine notes, or $20,970 made up as follows, cash received by defendant, $3,884.04, interest thereon, $642.86, credit on prior notes, $14,116.16, including, among other things, credit of $11,106.48 on still older notes and interest thereon of $1,832.57, plus interest on the $14,116.16 of $2,329.17. Defendant owed $21,764.26 after this series of nine notes and when he executed the note of September 29, 1936, less a cash payment of $1,864.04 made December 31, 1935 (R. 232), or $19,900.22.

The next twelve notes beginning with the September 29, 1936 note paid the preceding note indebtedness of $19,900.22 with a balance in plaintiff's favor of $99.78. On these twelve notes, defendant received $2000 in cash for which he paid $330 in interest. He paid $3,283.54 interest for the credit of $19,900.22. When defendant executed the first note sued on of August 31, 1937, he owed the preceding twelve notes amounting to $25,630 less the above balance in plaintiff's favor of $99.78 and less cash paid by him of $3,999.54 during the period covered by these twelve notes (R. 232) or $21,530.68. The interest of $3,283.54 will be referred to below as unrecoverable usury.

It was demonstrated that defendant's indebtedness on a given group of notes in consideration of credit

on his indebtedness on a given group of prior notes, which included interest, was infected with usury to the extent that it exceeded the indebtedness to which the credit was applied. Accordingly, by way of recapitulation, the portions of defendant's note indebtedness designated above as usurious are not recoverable by plaintiff, these portions being as follows: $1,409.65, supra, page 9; $1,832.57, supra, page 10; $2,329.17, supra, page 11; $3,283.54, supra, page 11; total $8,854.93.

This total deducted from defendant's note indebtedness when the August 31, 1937 note was executed, that is $21,530.68, leaves a balance of $12,675.75, on August 31, 1937, when defendant executed the first note sued on. Plaintiff applied to this balance on and after August 31, 1937, the total of $15,183.18 (R. 232) paid by defendant in cash, over-paying his note indebtedness due on August 31, 1937 by $2,507.43. Seven of the notes sued on are, therefore, without consideration since their proceeds were applied to this discharged indebtedness. The over-payment of $2,507.43 offsets rebates paid by plaintiff to defendant in the sum of $2,083.66 (R. 191-225), leaving a balance of $423.77 applicable to the balance claimed of $621.48 on the note, Exhibit D-1, R. 31, on which defendant received $2000 in cash. Defendant owes plaintiff $423.77.

The usury in the sum of $8,854.93 embraced in defendant's note indebtedness of August 31, 1934, in the above sum of $21,530.68 is interest on loans to pay

loans which included interest. The term covered by the interest on the loans thus paid was 15 months within which period 15 monthly installments of principal and interest ($155.32 in case of $2000 loan carrying $330 interest) were payable. It is defendant's contention that plaintiff was not entitled to charge interest for the same term of these installments or on credits with which to pay the same as plaintiff in fact did. That is, when the first installment of $155.32 including interest for 15 months fell due, plaintiff was not entitled to charge interest again on this sum for 15 months whether under the guise of forbearance or credit from a new note. It was the accumulation of such unauthorized charges of interest that made up the above usury of $8,854.93.

It is to be noted in this connection that the first installment of a note was paid when due 30 days after date by the next note, the first installment of which was paid 30 days after date. If the latter installment is applied to the former installment, the former was paid in 30 days. It cannot be argued, therefore, that there was a 15 months' extension of time or forbearance on this installment for which interest was charged at the rate of one per cent per month on the amount of the installment or the credit with which to pay it, and that the 15-month period overlaps the period for which interest was included in the former note. Even if it can be said that defendant borrowed $155.32 for 15 months to pay an installment due at the time, paying interest at one per cent per month

for the period, the fact is he paid an equivalent sum in 30 days. Interest covering the remaining 14 months was not earned, and the first month was one of the fifteen months for which interest on the same amount had been charged in the former note.

CONCLUSION.

The foregoing argument acquiesced in the Supreme Court's approval of the interest charges made by plaintiff. It points out the continuity of the transaction between the parties and the compounding of interests at monthly intervals which was latent in the transaction. If it had been hinted to the Supreme Court that when defendant gave a new note to cover an interest bearing installment of a prior note plus interest thereon, interest was thus compounded and that interest continued to be thus compounded monthly in geometric progression, the Court would have given defendant credit for the compound interest on his notes covering the same, or would have remanded the case to the trial Court for a restatement of the account between the parties as was done in the similar case of *Nawahi v. Trust Company,* 30 Haw. 359. If it had been hinted to the Supreme Court that when defendant gave a new note to cover an interest bearing installment of a prior note, and to cover also interest for the same period for which the interest in the installment was charged, the Court would not have countenanced the twofold interest

charge but would have given defendant credit for the second charge on his note indebtedness.

It is submitted that in view of the complicated accounts involved, the case should be remanded to the trial Court for a statement of account between the parties.

Dated, Honolulu, T. H.,
August 12, 1948.

Respectfully submitted,
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